This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 08 KUWAIT 000113

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STATE FOR EB/IFD/OIA
STATE PLEASE PASS TO USTR
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TAGS: ECON KTDB KU OPIC USTR
SUBJECT: KUWAIT 2005 INVESTMENT CLIMATE STATEMENT

REF: 2004 STATE 250356

¶1. Per reftel, included below is the full text of Embassy Kuwait's 2005 Investment Climate Statement.

¶2.

INVESTMENT CLIMATE STATEMENT

OPENNESS TO FOREIGN INVESTMENT

The Council of Ministers approved the implementing regulations for its new Direct Foreign Capital Investment Law-Law No. 8/2001- passed by the National Assembly on March 11, 2001, through Resolution No. 1006/1/2003 on November 1, ¶2003. The legislation authorizes foreign-majority ownership and 100 percent foreign ownership in certain industries including: infrastructure projects (water, power, waste water treatment or communications); investment and exchange companies; insurance companies; information technology and software development; hospitals and pharmaceuticals; air, land and sea freight; tourism, hotels, and entertainment; housing projects and urban development. Projects involving oil discovery or oil and gas production are not authorized for foreign investment and must be approved by a separate law.

The Direct Foreign Capital Investment Law promotes foreign investment in Kuwait; authorizes tax holidays of up to ten years for new foreign investors; facilitates the entry of expatriate labor; authorizes land grants and duty-free import of equipment; provides guarantees against expropriation without compensation; ensures the right to repatriate profits; and protects the confidentiality of proprietary information in investment applications, with penalties for government officials who reveal such data to unauthorized persons. New investors will be protected against any future changes to the law. Full benefit of these incentives, however, will be linked to the percentage of Kuwaiti labor employed by the new venture. The investor will also be obliged to preserve the safety of the environment, uphold public order and morals, and comply with instructions regarding security and public health. While the Direct Foreign Capital Investment Law is on the books, foreign companies still report numerous delays in getting approval to operate in Kuwait and the law does not appear to have changed the investment climate all that much. (The Minister of Finance did not renew the term of the Assistant Undersecretary who is in charge of the Direct Foreign Investment Office). Some reports claim that the Minister will cancel or change it into an authority after a recent report by the Economic Reform Committee describing it as complete failure).

Foreign firms still may not invest in the upstream petroleum sector, although they are permitted to invest in petrochemical joint ventures. Implementing legislation brought before Parliament in January 2004 would allow for limited, controlled investment in the petroleum sector. This law was submitted specifically to allow for investment in and development of Kuwait's northern oilfields, but may be used to allow for other investment in the petroleum sector in the future.

Kuwait's economy has been dominated by the state and the nationalized oil industry since the early 1970s despite efforts by the government to divest. The government acquired major holdings in private Kuwaiti firms -- particularly banks and insurance companies -- following stock market crashes in 1979 and 1982. After liberation from Iraq (early in 1991), the government passed a debt settlement law and purchased outstanding debts emanating from the stock market crashes and the Gulf War. Between 1995 and 1998, the government successfully divested over 50 percent of its equity holdings in private firms by selling off its full holdings in 28 firms and portions of holdings in 17 other firms, earning some US $3.2 billion. The program was suspended in 1998 because of weakness of the Kuwait Stock Exchange, but resumed in May 2001 when the Kuwait Investment Authority sold 113 million

shares (about 24 percent) of the Mobile Telecommunications Company (MTC). There were six times as many prospective buyers as could be accommodated. The sale fulfilled the government's intention to reduce its equity in MTC from 49 percent to 25 percent.

The Kuwait Stock Exchange (KSE) is the second largest bourse in the Arab world after Saudi Arabia's NCFEI. KSE lists 113 Kuwaiti companies and 2 companies from other Gulf States. It reopened in 1992 following the Gulf War and has a market capitalization of US $61 billion (KD21.745 billion) as of December 2004. The index grew 389 percent between 1994-2003 as the government divested itself of private holdings. The National Assembly ratified the "Indirect Foreign Investment Law" in August 2000, allowing foreigners to own 100 percent of all listed shareholding companies, except banks. Foreign investors require Central Bank's approval to own more than five percent of a Kuwaiti bank, and are limited to a maximum ownership of 49%. The banking sector was opened under the Direct Foreign Investment Law and the Central Bank has already granted one foreign bank, BNP Paribas, a license to operate. Other foreign banks have expressed interest and will likely apply for licenses in 2005.

On July 9, 2001, the Kuwaiti government announced an ambitious five-year privatization program, which closely resembled past initiatives. The plan outlined a wide range of activities, but with little detail. The first year called for privatizing some gas station outlets and part or all of Kuwait Airways, which has operated at a loss since 2000. Year two initiated privatization of post office, telegraph, and telecommunication services. Years three and four will complete the telecommunication privatization and initiate the privatization of the Ports Authority and Public Transport Company. The fifth and final year targets the power and water sectors, as well as Kuwait's Petrochemical Industries Company (PIC). Kuwait's National Assembly has made clear that any privatization program will have to insulate consumers from significant rate increases and protect the jobs of Kuwaiti employees. Little of the 2001 five-year plan has been implemented. Kuwait Airways is still operating at a significant loss and is still a government entity. While both mobile telephone companies in Kuwait are private, none of the other communication services have yet been privatized, though talk is increasing of privatizing landlines. The ports and transport sector have not been privatized either. The energy and power sector has seen the most progress in privatization. Forty of the 120 government-owned gas stations have been privatized, with plans to privatize the rest in two additional rounds. The outcome will be three competing gas station companies, with gas still subsidized by the government and set in a price range. The government-owned lubrication oils plant was privatized in 2004 as were the coke smelter operations. Kuwait's PIC is now operating a joint private venture with Dow Chemicals called Equate, and the operation has proven to be a successful, profitable model of both privatization and foreign investment.

Build, Operate and Transfer (BOT) projects are gaining increasing acceptance in Kuwait, with BOT projects proposed in the power, wastewater, real estate development and transport sectors. After nearly four years of deliberation the Sulaibiya Waste Water Treatment BOT contract was signed in May 2001. The winning consortium, which includes U.S. firms, projects revenues of US $390 million over 10 years. The project will process 50 million gallons of wastewater daily to be used for irrigation.

There have also been selected real estate BOT projects by privately owned Kuwaiti companies. The first-class US $132 million Sharq Mall, owned by the National Real Estate Company, contains retail outlets, restaurants, theaters, and entertainment concessions. More recently, the Fifth Waterfront Development Project constructed Marina Mall. This US $162 million BOT is owned by the United Realty Company and features high-end retail, eating, and entertainment outlets. A future BOT is planned for a central incinerator in the Shuaiba Industrial Area, a project which stipulates foreign participation with at least 25 percent equity.

Foreign-owned firms and the foreign-owned portions of joint ventures are the only businesses subject to corporate income tax, which applies to domestic and offshore income. Corporate tax rates can be as high as 55 percent of net profits, but the government has put forward legislation to reduce the maximum rate to 25 percent. New foreign investors can be exempted from all taxes for up to 10 years under the new Direct Foreign Capital Investment Law. As of January 2004, the new draft taxation law lowering the corporate tax rate to 25% on all sectors was still held up in Parliament.

Kuwaiti firms are not subject to the corporate income tax, but those registered on the Kuwait Stock Exchange (shareholding companies) are required to contribute 2.5 percent of their national earnings to the Kuwait Foundation

for the Advancement of Science (KFAS). The National Employment Law levies an additional 2.5 percent tax that will fund a program granting Kuwaitis working in the private sector the same social and family allowances provided to Kuwait's government workers. Kuwait levies no personal income tax.

Tax exclusions -- besides those offered under the new Direct Foreign Capital Investment Law -- for business expenses are limited and Kuwait's tax code is often ambiguous. For example, deductions are only three percent for agent commissions and head office expenses (mainly for turnkey supply and installation-type contracts).
The licensing authority of the Ministry of Commerce and Industry screens all proposals for direct foreign investment. In the past, this authority has encouraged high-tech industries over sectors viewed to be saturated, such as the hotel industry. The Foreign Capital Investment Committee (FIC), chaired by the Minister of Commerce and Industry and including representatives from the private and public sectors, will authorize investment incentives put forth under the new Foreign Investment Law on a case-by-case basis. Foreign companies have reported numerous delays in gaining authorization, some waiting up to 18 months for approval.

CONVERSION AND TRANSFER POLICIES

After 27 years of linking the Kuwaiti dinar (KD) exchange rate to a basket of currencies, Kuwait decided to peg the dinar to the US dollar under a flexible peg from the beginning of 2003. The move is in preparation for the adoption of a single GCC currency in 2010. The Central Bank of Kuwait (CBK) will retain a band of plus or minus 3.5 percent in order to ensure a smooth evolution of the historic behavior of the KD that has traded within the specified band since liberation. Since 1997, the KD has fluctuated within a 3 percent band against the dollar. There are no restrictions on current or capital account transactions in Kuwait beyond the requirement that all foreign exchange purchases be made through a bank or licensed foreign exchange dealer. Equity, loan capital, interest, dividends, profits, royalties, fees and personal savings can all be transferred in or out of Kuwait without hindrance. Under the new Foreign Investment Law, investors are also permitted to transfer all or part of their investment to another foreign or domestic investor.

*Source: National Bank of Kuwait Economic & Financial Review, June 2003.

EXPROPRIATION AND COMPENSATION

There have been no recent cases of expropriation or nationalization involving foreign investments in Kuwait. Nevertheless, as a safeguard, the new Direct Foreign Capital Investment Law guarantees against expropriation or nationalization except for the public benefit in accordance with existing laws; in this case, compensation will be provided without delay for the "real economic value of the project at the time of expropriation." When foreign companies were nationalized in the past, as with Kuwait's oil industry in the 1970s, the foreign interests were compensated promptly and effectively.

DISPUTE SETTLEMENT

The Foreign Investment Law stipulates that Kuwaiti courts alone are responsible for adjudicating any disputes involving a foreign investor and other parties, although arbitration is permitted. Few contracts in Kuwait contain clauses specifying recourse to traditional commercial and political negotiation. According to the Central Bank of Kuwait, the Kuwaiti judicial system recognizes and enforces foreign judgments only when reciprocal arrangements are in place. Kuwait is a signatory to the International Center for the Settlement of Investment Disputes (ICSID, i.e. the Washington Convention). There have been no investment disputes involving American firms in Kuwait in over five years; commercial disputes are more common. In both cases, the slow pace of Kuwait's legal system often frustrates American claimants.

Kuwait has a developed legal system and a strong trading history. It has a civil code system influenced by Islamic law. As a traditional trading nation, Kuwait's judiciary is familiar with international commercial laws. Kuwait has been a GATT member since 1963 and has signed a WTO agreement. Kuwait, however, is not a signatory to the WTO Government Procurement Code.

A feature of Kuwaiti law which U.S. business should be aware of is the application of travel bans which may be applied against individuals who have civil or criminal cases registered against them. The ban prevents individuals from departing Kuwait until the pending matter is settled or

acceptable guarantees are offered. There have been indictments in which former Kuwaiti business partners have managed to have travel bans imposed on former U.S. partners for allegedly violating Kuwaiti civil law. Though very infrequent, such cases highlight the need to take extra care before entering into long-term business relationships in Kuwait.

PERFORMANCE REQUIREMENTS/INCENTIVES

Government Procurement Requirements

Law No. 37 of 1964 (Articles 43 and 44) specifies the use of local products when available and prescribes a 15 percent price advantage for local firms in government tenders.

Boycotts

Kuwait publicly announced in June 1993 the end of enforcement of the secondary and tertiary Arab League boycotts of Israel. Although there are occasional reports that some tender requests contain boycott clauses reportable under U.S. anti-boycott laws, these usually result from clerical errors or the use of outdated forms. Kuwait has stated that it will wait for Arab League action before eliminating the primary boycott of Israel.

Shipping Requirements

The Kuwaiti government has insisted that cargoes for government projects originating in U.S. ports will no longer be prevented access in favor of the United Arab Shipping Program.

Participation In Research And Development

There are no specific restrictions on foreign participation in government-financed or subsidized research and development, but little activity of this kind has occurred to date. The Kuwait Institute for Scientific Research (KISR) has expressed interest in working with foreign firms. The government would welcome programs that provide expertise unavailable locally, but these are likely to be evaluated on a case-by-case basis.

Visa and Work Permit Requirements

Kuwait has a stringent visa regime and most work permits require a local sponsor. The Foreign Investment Law, however, may redress this problem for new investors. Reciprocal changes between the U.S. and Kuwait--particularly the introduction of a 10-year multiple entry visa--have benefited U.S. business travelers. Visa requirements for citizens of 34 nations, including the United States, were relaxed in 2004 allowing for application for a visa at the airport upon arrival. Foreign-born U.S. citizens, especially those of Middle Eastern descent, sometimes experience difficulties with visa and residency applications. Any problems experienced by potential U.S. visitors should be referred to the American Embassy or to the Bureau of Consular Affairs, Department of State.

RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

Rights to private ownership and establishment are respected in Kuwait, although foreigners face selected restrictions. Licenses from the Ministry of Commerce and Industry are required for the establishment of all new companies, and government authorization is required for any incentives offered by the new Foreign Investment Law. As stated above, foreign ownership is restricted or prohibited in some sectors of the economy, and non-GCC citizens may not own land in Kuwait.

Kuwaiti law severely restricts the types of collateral to which creditors may have recourse in the event of default by a borrower. Banks may not foreclose on residential real estate property or personal possessions in the event of default, although they may sue the borrower for the balance due under the loan contract. Borrowers typically pledge a portion of their future severance benefits as collateral for a bank loan.

TRANSPARENCY OF THE REGULATORY SYSTEM

Kuwait has not developed effective antitrust laws to foster competition, and its bureaucracy often resembles that of a developing country. Kuwait's open economy has generally promoted a competitive market. When government intervention occurs, however, it is usually to the benefit of Kuwaiti citizens and Kuwaiti-owned firms.

EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

Kuwait has a free, but inefficient, capital market where credit is allocated on market terms. Foreign investors can obtain credit through local banks. With the help of government subsidies, the financial markets -- and particularly the commercial banks -- operated throughout the 1980s primarily to collect funds for the re-lending to favored customers. Payment discipline was lax and real economic losses common. Under a bank stabilization program introduced in 1992, the Central Bank of Kuwait purchased all of the outstanding domestic credits of Kuwait's commercial banks while eliminating all guarantees for profits, equity, and liabilities other than the banks' deposit liabilities. Henceforth, all losses would stay with the banks, which would be responsible for the management of all their assets and liabilities. In addition, the Central Bank improved bank supervision, resulting in a fairer and more efficient distribution of credit throughout the Kuwaiti banking system. Each of Kuwait's six commercial banks reported continued earnings growth in 2002.

BANK ASSETS

Kuwait's banks have not yet released their 2004 annual reports. The assets of Kuwait's commercial banks on December 31, 2003 were: (in '000s)

BANK	KD	U.S. $ equivalent
National Bank of Kuwait	5,439,105	18,190,987
Gulf Bank	2,483,522	8,306,094
Commercial Bank of Kuwait	2,198,250	7,352,006
Al-Ahli Bank	1,480,077	4,950,090
Burgan Bank	1,920,300	6,422,408
Bank of Kuwait and the Middle East	1,495,447	5,001,495
TOTAL	15,016,701	50,223,080

(US $1 equals KD 0.291 as of Jan. 1st, 2005-CBK)

The quality of local banks varies from blue chip, world-class to weak. Some bank assets have been non-performing in the past. The balance sheets of some local banks are heavily weighted toward lower-yielding government bonds. Legal, regulatory, and accounting systems are opaque but are generally consistent with international norms. The Central Bank of Kuwait requires annual reports from local banks to meet international accounting standards. U.S. businesspeople are advised to seek local legal and financial advice for complicated investments and transactions.

There are few defensive measures to protect against hostile takeovers, which are rare in Kuwait. There is no evidence of private sector or government efforts to restrict foreign participation in industry standards-setting consortia or organizations. U.S. suppliers often have trouble, however, complying with specifications that are technologically-tailored to other (usually European, especially U.K.) suppliers. In addition, American suppliers' preference for turnkey projects often does not mesh with Kuwait's preference to split projects into a series of separately-tendered smaller projects.

Finally, U.S. investors should be aware that family, clan, and tribal ties throughout the business community and government can restrict foreign participation, investment, and control of domestic enterprises. Kuwait is a very big small town.

POLITICAL VIOLENCE

Politically Motivated Damage to Projects and/or Installations
The potential for terrorist actions throughout the Persian Gulf region remains high, and the Government of Kuwait continues to take aggressive steps to ensure domestic security. Between October 2002 and January 2004, there were four terrorist attacks targeting Americans in Kuwait, killing two Americans and wounding four others. There have been no incidents since.

CORRUPTION

The often-lengthy procurement process in Kuwait occasionally results in accusations of attempted bribery or the offering of other inducements by foreign bidders. This is a crime in Kuwait and there are currently several investigations and trials underway involving current or former government officials accused of malfeasance. There have been no convictions for bribery, however, since the end of the Gulf War. In 1996, the government passed Law No. 25, which requires all companies securing contracts with the government valued at KD 100,000 (US $336,000) or more to report all payments made to Kuwaiti agents or advisors while securing the contract. The law similarly requires entities and

individuals in Kuwait to report any payments they received as compensation for securing government contracts.

BILATERAL INVESTMENT AGREEMENTS

Kuwait has signed investment agreements with Germany, France, Italy, Russia, China, Romania, Poland, Hungary, Turkey, Malaysia, Pakistan, Switzerland, Malta, Finland, Ethiopia, Croatia, Tajikistan, Austria, Bulgaria, Kazakhstan, Morocco, Mongolia and the Czech Republic. In the past few years, Kuwait has signed a bilateral investment agreement with Pakistan and a free trade agreement (FTA) with Jordan. Kuwait has initialed agreements on bilateral investment with Denmark, Belgium, the Netherlands, Thailand, Ukraine, Latvia, Lithuania, Lebanon, Bosnia/Herzegovina, and India. Kuwait began talks with Singapore on a Free Trade Agreement in December 2004.

Trade and Investment Framework Agreement

Kuwait signed a trade and Investment Framework Agreement (TIFA) with the United States in February 2004. The TIFA is the first step in developing economic reform and trade liberalization criteria to strengthen the U.S. - Kuwait economic relationship and to work toward an eventual Free Trade Agreement. At the first bilateral TIFA Council meeting, held in May 2004 in Washington, D.C., it was agreed that the TIFA process would provide for periodic technical discussions. Several areas in particular stand out as needing further attention: intellectual property rights, standards-related issues, and service and investment requirements. Technical experts on both sides continue to work on these areas. The U.S. Embassy in Kuwait, the Kuwaiti Embassy in Washington, the USTR, and the Kuwaiti Ministry of Commerce and Industry are working on bringing all sides together for the next TIFA Council Meeting in the first half of 2005.

OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

In 1989, Kuwait concluded an agreement with the U.S. on investment guaranty programs, which facilitated the extension of programs from the Overseas Private Investment Corporation (OPIC) to Kuwait. Kuwait is also a member of the Multilateral Investment Guarantee Agency (MIGA). Currently there are no OPIC programs in Kuwait.

LABOR

Kuwait has a diverse labor force. Kuwaiti nationals occupy most of the top management positions in the private and government sectors. Unemployment among Kuwaitis is less than two percent, but is rising as a result of a growing influx of young Kuwaitis into the labor force (20,000 to 25,000 annually). The new entrants are reluctant to enter the private sector and cannot be absorbed by the government, where underemployment remains a serious problem. Kuwaitis are outnumbered in the work force by expatriate laborers of diverse backgrounds. While there are a number of American and Western European workers in Kuwait, particularly in high-skilled positions, the vast majority of expatriate workers are low paid laborers from other Middle Eastern countries, South Asia, and the Philippines. Prior to the Gulf War (1991), Palestinians occupied many of the country's middle-management positions. Since the war, workers of other nationalities, often Egyptians or South Asians, have filled most of these positions. Since liberation, the Government of Kuwait has adopted inconsistent policies intended to limit and discourage the resident expatriate population. The government has instituted a quota system on work permits, restricted the transfer of workers from one sponsor to another within the private sector, and levied new fees on expatriate workers and their families in order to raise the cost of employing foreign workers. At the same time, however, the government has reduced the minimum salary required for expatriates (in some business categories) to be eligible to bring their families to Kuwait, lowering it from 400 KD a month to 250 KD a month.

Kuwaiti workers have the right to organize and bargain collectively, but Kuwaiti law prevents the establishment of more than one union per functional area or more than one general confederation. Foreign workers, who constitute the vast majority of the work force, are permitted by law to join unions as non-voting members after five years of residence in Kuwait. The right to strike is also recognized for private sector workers, though that right is limited by provisions calling for compulsory negotiation and arbitration in the case of disputes. Kuwaiti labor law prohibits anti-union discrimination.

Separate Kuwaiti labor laws set work conditions in the public and private sectors, with the oil industry treated

separately. Forced labor is prohibited and the minimum age for employment is 18 years. Youths as young as 14, however, may work part-time in some non-industrial positions. A two-tiered labor market ensures high wages for Kuwaiti employees while foreign workers, particularly unskilled laborers, receive substantially lower wages. There is no minimum wage for the private sector; in the public sector, the current effective minimum wage is KD 226 (US $741) per month for Kuwaiti bachelors and KD 301 (US $987) per month for married Kuwaitis--compared to KD 90 (US $295) for non-Kuwaitis. The basic labor law also limits the workweek to 48 hours, provides for a minimum of 14 days of leave per year, and establishes a compensation schedule for industrial accidents. Current labor laws do not apply to domestic servants. The State Department's annual Human Rights Report and Trafficking in Persons Report highlight the vulnerability of domestic servants to exploitation. The Ministry of Social Affairs and Labor announced a draft law to give domestic servants some of their rights like limited number of weekly work hours, minimum salary, and a weekly holiday.

The International Labor Organization's (ILO) Committee of Experts has reiterated its long-standing criticisms of the discrepancies between the Kuwaiti Labor Code and ILO Conventions 1, 30, and 87 regarding hours of work and freedom of association. Areas criticized by the ILO include the prohibition to establish more than one trade union for a given field; the requirement that a new union have at least 100 workers; the regulation that workers must reside in Kuwait for five years before joining a trade union; the denial of the right to vote and to be elected for foreign trade unionists; the prohibition against trade unions engaging in any political or religious activity; and the reversion of trade union assets to the Ministry of Social Affairs and Labor in the event of dissolution. A new labor law has been under consideration for over 10 years.

FOREIGN TRADE ZONES AND FREE PORTS

In July 1995, the National Assembly passed Law No. 26 authorizing the Ministry of Commerce and Industry to establish free trade zones in Kuwait. In May 1998, the privately-owned National Real Estate Company signed a contract with the Ministry to operate, manage, and market the 50 square-kilometer Kuwait Free Trade Zone (KFTZ) at Shuwaikh port, which was inaugurated in November 1999. Many restrictions faced by foreign firms, such as corporate taxes, do not apply to offices or plants within the KFTZ. Some 90 percent of space within the KFTZ has been leased; the majority of firms operating in the zone are Kuwaiti.

FOREIGN DIRECT INVESTMENT STATISTICS

Kuwaiti public investments abroad consist of portfolio investments held by the Kuwait Investment Authority, direct investments of other government entities, as well as those held by private Kuwaitis. The amount of investments of the KIA is a state secret, but is estimated at more than US $80 billion. Details about non-KIA investments -- such as the Kuwait Petroleum Corporation's interests in oil production, refining, and distribution -- are equally murky. The holdings of private Kuwaitis, in both direct and portfolio investments, are believed to be some US $100 billion. Other major investors in Kuwait include the Japanese-owned Arabian Oil Company which holds the Kuwaiti offshore concession in the Partitioned Neutral Zone (PNZ), and Dow Chemical which has a 45 percent stake in the US $2 billion Equate project, a petrochemical joint venture with the Petrochemical Industries Company (PIC) that began operation in 1997. (Although the U.S.-owned Saudi Arabian Texaco is headquartered on the Kuwait side of the PNZ, it operates under a Saudi concession for Saudi Arabia's share of the onshore oil resources in the PNZ.)
LEBARON